

General Information Letter: Taxpayer providing marketing services is not protected by Public Law 86-272.

September 16, 1999

Dear:

This is in response to your letter dated July 30, 1999. Given the nature of your inquiry and the information you provide, I am responding with a General Information Letter. This is not to be taken as a statement of Department policy or as a binding ruling by the Department. As general information gathered in response to your particular questions, however, I hope that it is helpful to you. See 86 Ill. Adm. Code 1200.120(b) and (c).

In your letter you have stated the following:

I represent a XXXXXXXXXXXX Corporation that will start utilizing independent contractors within your state, on or about October 1, 1999 to perform the services further detailed herein.

The independent contractors purchase territories within which they can represent our client. The territories are owned and operated by the independent contractor and are saleable. The contractor operates without supervision and can hire and fire his or her employees. These contractors can represent other companies and can operate in any form of legal entity.

Based on the above, and the facts represented herein, I would like to know if our client is considered to be doing business in your state and has to register for authorization to do so and whether or not the services provided are subject to any other applicable taxes, i.e. sales tax, income tax, corporation tax, etc.

The services provided are as follows:

The taxpayer supplies the consumer with a directory of merchants that honor a discount program. Membership in this discount program is evidenced by a card that has my client's name on it. The consumer obtains a discount or in kind gifts from the merchant, telephone time on a prepaid card, and eligibility to be in a monthly cash drawing.

My client bills the merchant for each time a consumer utilizes the program. The billing to the merchant is done electronically via an independent outside service. The transaction fee is determined based on the average dollar value of a sale, and is determined by the independent contractor. The independent contractor is paid a commission ranging between 40% and 45% of the billing to the merchant.

In order for a consumer to utilize the program, they must present their card which gets "swiped" through a terminal machine that records the usage and fees due from the merchant as well as the telephone time credits due the customer, and the entry into the cash sweepstakes drawing.

My client mails the merchant directory and the membership card to the consumers utilizing an outside mailing service.

The independent contractor purchases a territory or territories identified by zip code and priced based on the residential population of the designated zip code. The independent contractor must solicit the merchants within the given territory to subscribe to this promotional plan. I trust that the above adequately describes the business/service provided by my client within your state. However, should you have any questions, please feel free to contact the undersigned.

### **Response**

This letter is in response to the question of doing business in Illinois as it applies to the Illinois income tax. A different section of the Legal Services Office will be assessing your letter for other tax implications.

Under Section 201 of the Illinois Income Tax Act ("IITA"), a tax measured by net income is imposed on a corporation for the privilege of earning or receiving income in this State. Consistent with the standards of constitutional due process and the commerce clause, Illinois requires the filing of a return and payment of tax on income for any person doing business in Illinois.

It seems that your client is selling a marketing service that uses discounts and prizes as an incentive to consumers to patronize merchants who contract with your client. It resembles the merchandise stamp giveaway program once popular in retail. Your client updates the program with magnetic strip card technology, but is ultimately providing a service. As such it will not be afforded the protections of PL 86-272, the federal prohibition against state taxation of a multistate vendor whose only activity within the state is solicitation for orders filled from outside the state (15 USCA 381-384).

The test for determining whether your client does business within Illinois is therefore the "substantial presence" test formulated in *Quill v. North Dakota*, 112 S. Ct. 1904 (1992) in its interpretation of the commerce clause of the U.S. Constitution. If your client's activities comprise "substantial presence" in Illinois, it will have established nexus and its income will be apportioned between Illinois and other states for income tax purposes.

This Department does not issue a binding ruling on the issue of nexus outside the context of an audit, but certain general principles can be discussed given the facts outlined in your letter. Your client appears to have three potential instances of physical presence in Illinois under your scenario. The first is the magnetic card that identifies a consumer as a member. The second is the independent contractor who acts as your agent in Illinois. The third is the card reader located at each place of business that uses your client's services. Any one or a combination of these instances of presence could effectively meet the *Quill* test.

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As stated above, this is a general information letter that does not constitute a statement of policy that applies, interprets or prescribes tax law. It is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Sincerely,

Kent R. Steinkamp  
Staff Attorney -- Income Tax